STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

North Shore Gas Company	:	
	:	
Proposed General Increase in Rates for Gas Service	:	**Docket No. 09-0166**
	:	
	:	**(cons.)**
The Peoples Gas Light and Coke Company	:	
	:	
	:	**Docket No. 09-0167**
Proposed General Increase in Rates for Gas Service	:	
	:	

REPLY BRIEF ON EXCEPTIONS OF THE STAFF OF THE ILLINOIS COMMERCE COMMISSION

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STAFF OF THE ILLINOIS COMMERCE COMMISSION

Now comes the Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned attorneys, and pursuant to Section 200.830 of the Rules of Practice of the Illinois Commerce Commission ("Commission"), 83 Ill. Adm. Code Section 200.830, respectfully submits this Reply Brief on Exceptions to the briefs on exceptions ("BOEs") filed by North Shore Gas Company ("North Shore" or the "Company") and The Peoples Gas Light And Coke Company ("Peoples Gas" or the "Company") (collectively referred to as the "Companies" or "Utilities") ("the Companies' BOE" or "Companies BOE"); the People Of The State Of Illinois ("AG's BOE"); the Retail Gas Suppliers ("RGS' BOE"); Constellation NewEnergy-Gas Division, LLC's BOE ("CNE-Gas' BOE" or "CNE-Gas BOE; and the Citizens Utility Board And The City Of Chicago ("CUB-City's BOE") which were filed on or before November 24, 2009 in

response to the Administrative Law Judges' Proposed Order ("Proposed Order" or "PO") issued November 6, 2009.

IV. RATE BASE

C. Plant (All Subjects Relate to NS and PGL Unless Otherwise Noted)

2. Gathering System Phase 2 Project (PGL)

Exception No. 5

Peoples Gas argues that the Commission should reject the PO's adjustment to remove the Gathering System Phase 2 Project because Peoples Gas itself already removed this project from the forecasted plant additions in its rebuttal testimony. NS-PGL BOE, p. 16. This argument is misleading and the Commission should reject it. The PO concluded:

> The Commission finds that the Company has failed to provide sufficient evidence to include Phase 2 in its **rate base**. In particular, the Commission notes that the Company just started Phase 1 and, thus, there is no support for the amounts proposed to be included. The results of the Phase 1 engineering study, which will show the extent of the needed replacement, are not available. Without this evidence, **the Commission cannot say to what extent it will be prudent to replace these existing pipes**. Although not controlling, we also note that unlike the forecasted plant additions issue, no approval has been received from the Company's Board of Directors. **The Commission cannot include in rate base a project of unknown magnitude and need**

PO, p. 18, (emphasis added). The PO is clear that that the project should not be included in rate base because there is insufficient evidence to show that the project is prudent at this time. Id.

The net effect of Peoples Gas' rebuttal adjustment was that the Gathering System Phase 2 project was not removed from rate base. Peoples Gas merely reclassified the Gathering System Phase 2 project from Plant in Service to Construction Work in Progress, both of which are components of rate base. NS-PGL BOE, p. 17. In

other words, what PGL actually did in its rebuttal testimony was simply move the project from one rate base line item to another.

The reason Peoples Gas gives for transferring the project does not address the PO's concern about the project, which is that the project has not been shown to be prudent. PO, p. 18. Peoples Gas transferred the project because of changed expectations about its timing. NS-PGL Ex. JH-2.3P at 2; NS-PGL BOE, pp. 16-17. This has nothing to do with whether it is prudent to undertake the project in the first place. A project's prudency is not a function of the label or category to which it is assigned. Staff witness Seagle discussed in his direct testimony the nature of a prudence determination and none of his discussion was dependent upon any reference to the rate base category or label affixed to a particular project. Staff Ex. 13.0, p. 8, lines 143-167. Peoples Gas' argument is nothing more than a thinly veiled shell game offered up for the first time in its BOE. It should be noted that although Peoples Gas states that this change to the projects' status occurred in its rebuttal testimony, this particular argument did not surface prior to its Brief on Exceptions. Peoples Gas' surrebuttal testimony contains no discussion of Peoples Gas' recently formulated position that re-categorization has somehow rendered Staff witness' Seagle's prudence disallowance moot. Similarly, Peoples Gas did not offer this argument at the hearing or in either of its initial or reply briefs. Staff witness Seagles' direct and rebuttal testimonies outline the Commission's standards for a prudence determination. Staff's proposed prudence disallowance of the Gathering System Phase 2 was clearly stated in the rebuttal testimony of Staff witness Seagle as follows:

> However, I continue to recommend the Commission remove Peoples Gas' projected costs for Phase 2 of the Gas Gathering System Replacement

project because *the Company has not provided sufficient information to allow the Commission to reach a determination that this project was prudent and used and useful.* Therefore, my current recommendation is for the Commission to remove all of the Phase 2 costs associated with the project.

Staff Ex. 27.0, p. 11, (*emphasis added.* Later in Staff rebuttal testimony, Staff witness Seagle further discusses the reasons for his continued recommendation for a prudence disallowance due to the Company's failure to demonstrate the prudence of the project:

> Q. Did Mr. Puracchio's rebuttal testimony provide sufficient information regarding Phase 2 of the Gas Gathering System Replacement project to allow you to reach a determination that this project was *prudent and used and useful?*
>
> A. *No*. Mr. Puracchio in his rebuttal testimony NS-PGL Ex. TLP-2.0, lines 122-126 explains the timeline for the project is not certain without the engineering study. He also explains that Peoples Gas cannot know the complete extent of the scope of Phase 2 until the completion of Phase 1. Mr. Puracchio then makes an unsubstantiated claim that Peoples Gas will make a planned test year expenditure associated with this project of $5,700,000 and provides an estimate for the full cost of this project. However, he also admits that the full cost of the project depends on the outcome of Phase 1 of the project.
>
> Q. What do you recommend regarding the Gas Gathering System Replacement project?
>
> A. I am amending my recommendation to the Commission to allow Peoples Gas to recover the costs associated with the engineering study (Phase 1) associated with the project. *However, I continue to recommend the removal of the costs associated with Phase 2 of this project.* Therefore, I am recommending the removal from the year-end balance of $5,700,000 in 2010 for Phase 2 of this project."

Staff Ex. 27.0, pp. 12-13, (*emphasis added)*

Moving the Gathering System project from one rate base category to another rate base category, as Peoples Gas has done, does nothing to eliminate Staff witness Seagle's determination that PGL had not demonstrated that the project is prudent. The PO correctly concluded that the Gathering System Phase 2 project costs should not be

allowed since the Company has failed to provide sufficient evidence to determine that Phase 2 is a prudent project.

In the last paragraph of Section C of its BOE on page 18, Peoples Gas argues that since the Gathering System Phase 2 project has been re-categorized as Construction Work in Progress, that no derivative adjustments need be made. Staff does not take issue with that argument. Peoples Gas reflected these derivative adjustments when it transferred the project from plant in service to construction work in progress. The prudence disallowance for the Gathering System Phase 2 should not be reduced a second time for accumulated depreciation, ADIT and depreciation expense. The full amount of the disallowance adjustment should be the average amount of $2,850,000. NS-PGL BOE, p. 16.

In addition to its CWIP argument previously addressed above, Peoples Gas makes two claims to support this position. First, Peoples Gas claims that the record shows that any uncertainty associated with this project is limited only to pipe replacement in the later years of the project. NS-PGL BOE, p. 18. Second, Peoples Gas claims the record indicates it is certain to obtain Board approval for this project by late 2009 or early 2010. *Id.* Staff disputes each of these claims.

Staff witness Seagle noted Peoples Gas failed to provide any documentation, such as a cost benefit analysis or business case that is necessary to allow Staff or the Commission to verify the prudence and used and usefulness of the project. ICC Staff Ex. 13.0, p. 11. Further, the Company itself admits that the cost benefit analysis and business case are necessary to demonstrate that the project is prudent and used and useful. Peoples Gas Ex. TLP-1.0, p. 10. However, Peoples Gas was unable to provide

these documents for the record. Therefore, Peoples Gas has provided no support to include the requested costs for its phase 2 gathering system replacement project in its rates. With respect to the Company's argument that "any uncertainty [related to the project] is limited to some of the pipe replacement in later years of the project." (NS-PGL BOE, p. 18) Staff disputes that argument for three reasons.

First, Staff witness Seagle noted that PGL claimed the project was needed, in part, due to corrosion on the existing gathering system. ICC Staff Ex. 13.0, p. 9. However, Peoples Gas failed to provide any record evidence to substantiate this claim. Second, Staff witness Seagle noted that Peoples Gas failed to demonstrate that it is pursing this project prior to the end of the 2010 test year. Mr. Seagle noted that the absence of a completed engineering study (Phase 1 of project) and the absence of a cost benefit analysis or business case for the project demonstrates that the Company cannot produce a definitive timeline for the project. ICC Staff Ex. 13.0, pp. 11-12. Third, the Company admitted that until the completion of the engineering study, Phase 1, there will be some uncertainty involved in pursuing this addition. NS-PGL Ex. TLP-2.0, pp. 4-5. In other words, Peoples Gas could postpone or cancel the project even if the phase 1 engineering study shows some action is needed. Peoples Gas also places reliance on the engineering study to determine the full scope of the project, which includes whether Peoples Gas truly needs to proceed with the project in 2010 or not. Without a completed engineering study, Peoples Gas cannot conduct a cost benefit analysis or business case for the project. In short, Peoples Gas has provided nothing but its good intentions to support that it will incur any costs or pursue Phase 2 of this project in the 2010 test year. The record clearly shows that Peoples Gas' claim that only one small

area of uncertainty exists with respect to the inclusion of costs for the gas gathering system phase 2 project is overstated. Therefore, the Commission should reject Peoples Gas' claim and rely on the PO that properly recognized the overall uncertainty associated with this project.

Finally, Peoples Gas argues that "the un-contradicted evidence is that Board approval is expected in late 2009 or early 2010." NS-PGL BOE, p. 18. Staff disputes this argument for two reasons. First, Peoples Gas has no means of demonstrating with any level of certainty that it will be granted approval for this project. As Staff witness Seagle noted, Peoples Gas must have project approval from the board to demonstrate the project is needed in providing safe and reliable service to its natural gas customers. However, if a utility project does not have board approval, it raises a concern that either the project is not necessary or that the project is being delayed. ICC Staff Ex. 27.0, p. 9. Second, Peoples Gas admits until the completion of engineering study (Phase 1), it does not know the full scope of the project, which includes if the project is needed in 2010 or not, and it cannot conduct a cost benefit analysis or business case for the project. NS-PGL Ex. TLP-2.0, p. 6. Due to the potential monetary investment needed for the proposed project, Peoples Gas requires all of this information to seek approval for any expenditure from the Board of Directors. However, Peoples Gas has not completed any of the required studies nor has Peoples Gas received Board approval for any expenditure associated with Phase 2 of the project. Therefore, Peoples Gas' "evidence" for Board Approval being expected is contradicted by the uncertainty of the project while the engineering study has yet to be completed. ICC Staff Ex. 13.0, pp. 11-12.

Staff has demonstrated above that Peoples Gas' claims are unsubstantiated and should be rejected by the Commission. Therefore, Staff continues to support the PO's conclusion on this issue.

H. Pension Asset (PGL) / Liability (NS) and OPEB Liabilities

Peoples Gas' Pension Asset

Peoples Gas asserts that the PO is wrong in finding that Peoples Gas' pension asset was created with ratepayer supplied funds and, therefore, should be excluded from rate base. The Company bases its assertion on the rationale that the pension asset was created with contributions to the pension fund and/or negative pension expense. NS-PGL BOE, 19. Neither the payment of contributions nor the purported negative pension expense supports the Company's contention that the Peoples Gas pension asset was created with shareholder funds. As Staff has explained in testimony and briefs, and also in the Company's prior rate case, Docket Nos. 07-0241/-0242 (Cons.), absent a direct contribution from shareholders Peoples Gas obtains the money to fund its pension contributions from ratepayers through the collection of utility rates. Ratepayers bear the cost of the pension plan because employee benefit costs (i.e., positive pension expenses) are reflected in the operating expense component of the revenue requirement that forms the basis for setting rates. For this reason, ratepayers have borne, and continue to bear, the cost of the pension plan in utility rates. Accordingly, the PO correctly concludes that these contributions are funded by ratepayers, not shareholders.

The Company asserts that "a pension asset is created when annual pension cost computed under FAS 87 is a negative expense – meaning that the expected return on

plan assets exceeds other components of pension cost." NS-PGL BOE, p. 20. The Company has the cause and effect relationship backwards and wrongly suggests that negative pension expense represents shareholder supplied funds. The negative pension expense does not create the asset; rather, as admitted by the Company's witness, the negative pension expense arises because of the pension asset. NS-PGL Ex. AF-1.0, 9:180-188 ("The typical reason for a negative pension expense is that expected return on plan assets exceeds the other components of pension cost. In other words, the assumed investment return on plan assets is greater than the cost elements making up the annual pension cost."). That the Company has had negative pension expense for a number of years means only that it has benefited from having the pension asset for that period of time and has not reduced that asset to zero during that time period. The same holds true of the lump-sum distributions in lieu of annual pension plan benefits. These merely reduce the ultimate obligation that ratepayers are responsible for and, to the extent of the asset, have previously been funded through rates.

Regarding negative pension expense, the Company asserts that pension expense for the period from 1996 through 2003 was negative $174.3 million (NS-PGL BOE, p. 20) and maintains that "[**n]either the Proposed Order nor Staff has addressed this "evidence" of negative pension expense." NS-PGL BOE, p. 20,** (emphasis added)**.** First, it should be noted that Mr. Felsenthal presented this information in his surrebuttal testimony. NS-PGL Ex. AF-2.0, p. 5. As such, there was no opportunity for Staff to respond through testimony to Mr. Felsenthal's calculation of such amounts or to debate whether those amounts are substantively responsive or relevant to the analysis and position expressed in the rebuttal testimony of Ms. Pearce.

The information, as presented by Mr. Felsenthal in his surrebuttal testimony, is neither responsive nor relevant to the argument cited in Staff witness Pearce's rebuttal testimony. In her rebuttal testimony, Ms. Pearce made the statement:

> As stated previously, there is no information in the record of this proceeding to support the contention that Peoples Gas shareholders have made contributions to the pension plan in an amount $155,496,000 greater than the amounts collected from ratepayers through utility rates (or in any other amount). Moreover, based on the response to Staff Data Request BAP-12.03, during the most recent five-year period from 2004 to the present, including the Company's projection for the balance of 2009, total cash contributions by Peoples Gas to the pension plan total $37,743,228 and pension expense recorded by Peoples Gas totals $56,137,260 (ICC Staff Exhibit 16.0, Attachment A). This evidence demonstrates that just within the last five years, pension expense, which is recovered in rates, has exceeded pension contributions by $18,394,032.

ICC Staff Exhibit 16.0, at 9:213 – 225. This testimony demonstrates that shareholders did not provide the funds for the pension plan—rather, those costs were borne by ratepayers, as reflected in utility rates.

Ms. Pearce further addressed Mr. Felsenthal's assertion that the pension asset is the result of negative pension expense in the following section of her rebuttal testimony:

> Based on the Company's response to BAP 12.03 as cited above, it does not appear that Peoples Gas has reflected negative pension expense in the most recent five year period. Further, based on the Company's response to Staff Data Request BAP 15.05, Peoples Gas agrees that the two most recent rate proceedings in 1995 and 2007 did not contain negative pension expense (ICC Staff Exhibit 16.0, Attachment B). Moreover, based on the impact of the actuarial update on the 2010 test year, it appears the greatest impact results from the application of accounting rules that increased the regulatory asset.

ICC Staff Exhibit 16.0 at 12-13:301 – 309. As to the purported negative pension expense that allegedly benefited ratepayers during the years 1996 through 2003, Staff notes that the Company filed no rate cases during that time. Prior to the instant

proceeding, the Company's most recent request for a rate increase was Docket Nos. 07-0241/-0242 (Cons.). Prior to that case, the Company's most recent rate case was twelve years earlier, Docket No. 95-0032. Accordingly, the negative pension expense cited by Mr. Felsenthal was not reflected in customer rates, since the Company did not request a rate increase after 1995 until 2007. Consequently, ratepayers continued to pay rates based on the positive pension expense included in rates charged to customers during this time period. The Company has yet to explain how the purported negative pension expense that was never reflected in rates provided benefit to Peoples Gas ratepayers. Further, the Commission has long ago ruled that pension assets created by investment return factors rather than Company supplied contributions are "created from ratepayer-supplied funds" (ICC Docket No. 95-0219, (Nicor 1995 Rate Case) (1996 Ill. PUC LEXIS 204, p. 9)) and accordingly to allow a "return on an asset [ratepayers] have created through rates would be unreasonable …". ICC Docket No. 93-0301, (GTE 1993 Rate Case) (1994 PUC LEXIS 436, p. 7)

Finally, the Company argues that an additional reason for negative expense that is particularly relevant to Peoples Gas is the result of pension plan participants accepting lump-sum distributions in lieu of a stream of pension plan benefits, thereby eliminating pension plan obligations and triggering the recognition of a portion of unrealized gains. The Company's BOE alleges that the PO ignores that fact (NS-PGL BOE, p. 20); however, these curtailments are reflected in the actuarial valuation that forms the basis of the Company's annual pension expense—they do not merit a separate treatment. As such, the impact of these curtailments do not alter the fact that ratepayers bear the cost of such pension expense for the period. As a result, they

should have no impact on the Commission's repeated findings that ratepayers not shareholders bear the cost of the pension plan and therefore, should receive the corresponding benefits to which they are entitled. ICC Staff Exhibit 2.0, p. 6: 132 – 141.

Staff in testimony and briefs has consistently shown that the pension assets at issue were created with ratepayer funds. Accordingly, it is proper ratemaking treatment to exclude such assets from rate base since shareholders are not entitled to earn a return on funds provided by utility ratepayers. In the instant proceeding, Staff further noted that the identification of a "regulatory asset" denotes an amount the Company intends to recover in future rates: clearly, this amount does not represent shareholder funds. Accordingly, there is no basis to support the Company's contention that the Peoples Gas pension asset was created with shareholder funds.

Finally, the Company contends the PO also wrongly interpreted the recent decision by the Illinois Appellate Court that affirmed the Commission's decision in the 2005 Commonwealth Edison Company rate case, Docket No. 05-0597, concerning the treatment of a pension asset/pension contribution. It is illogical for the Company to rely on a court case which upheld the Commission's exclusion of a pension asset from rate base as a reason for including a pension asset in rate base in this case. The Commission is well aware that the facts in Docket No. 05-0597 are not in evidence in the instant proceeding and accordingly, provide no basis to support the inclusion of a pension asset or pension contribution in rate base. The differences between Docket No. 05-0597 and the instant proceeding have been thoroughly argued in testimony and briefs: there is no need to repeat those arguments here.

The Commission has consistently found that pension assets are created with ratepayer-supplied funds, not by shareholder-supplied funds. The facts of the instant proceeding provide no basis to deviate from this well-established ratemaking practice. To do so would unjustifiably allow shareholders to earn a return on a pension asset that is the result of ratepayer funding.

North Shore Pension and OPEB Liabilities and Peoples Gas OPEB Liability

North Shore further argues that the treatment of the Peoples Gas pension asset and OPEB liability and the North Shore pension and OPEB liabilities should all be included in rate base since they represent a commitment to pay retirees. NS-PGL BOE, p. 23. Staff agrees that these employee welfare plans represent a commitment to pay retirees: a commitment that will be reflected in utility rates and paid by ratepayers. For this reason, it is appropriate to reflect these liabilities as a reduction of rate base, and to exclude the pension asset from rate base. As explained in Staff's BOE, this treatment is consistent because it recognizes ratepayers as the source of funding for these obligations. Including the Peoples Gas pension asset in rate base would charge ratepayers twice—once through pension expense that is reflected as an operating expense in the revenue requirement and a second time by providing shareholders with a return on the pension asset. *See* Staff BOE, p. 11 - 12.

V. OPERATING EXPENSES

B. Uncontested Issues

2. Union Wages (Falls in Multiple Categories of O&M)

Technical Exception TC-1

Staff agrees with the Companies' Technical Exception No. TC-1.

7. Administrative & General

f. Civic, Political, and Related

Technical Exception No. TC-2

Staff supports the Companies' technical exception TC-2. The Companies correctly assert that the PO at page 42 in Section V.B.7.(f), Operating Expenses – Uncontested Issues – Civic, Political and Related Activities, addresses both the adjustments to the Utilities' operating expenses and rate base, and the Proposed Order (at 9) Section IV.B.2.(c), Rate Base – Uncontested Issues – Capitalized Civic, Political, and Related Activities, also addresses the rate base portion of this adjustment. The Companies request that the reference to rate base be deleted from the former paragraph. Staff agrees that it is not necessary for the Order to fully discuss the rate base adjustment in both places. The revised language offered by the Companies in their Technical Exception No. 2 would accomplish this.

The Companies' technical correction TC-2 has brought to Staff's attention that an additional clarification is needed to the Operating Expense section of the PO. Section V.B.7.(f) should also include language about the portion of this adjustment related to taxes other than income. This is also part of the adjustment the Companies accepted and reflected in their rebuttal testimony. Staff Exhibit 6.0, Schedules 6.4 P and 6.4 N; NS-PGL Ex. SM-2.0, 5:101; NS-PGL Ex. SM-2.2N, p. 1, col. [I]; and NS-PGL Ex. SM-2.2P, p. 1, col. [I]. Therefore, Staff recommends the following changes to the PO which incorporate the Companies' Technical Exception No. 2:

<u>Recommended Language</u>
PO, p. 42.

f) Civic, Political, and Related Activities

(1) The Record

Staff's proposal to reduce the operating expenses of North Shore and Peoples Gas by $2,000 and $6,000, for lobbying related taxes other than income, respectively, and their ~~rate bases of North Shore and Peoples Gas by $6,000 and $14,000, respectively, and their~~ operating and maintenance expenses by $10,000 and $23,000 (gross amounts), respectively, for expenses associated with lobbying and related activities is uncontested. Staff Ex. 6.0 at 6-7; NS-PGL SM-Ex. 2.0 at 5; NS-PGL Ex. JH-2.0 at 4.

(2) Commission Analysis and Conclusion

The Commission finds that Staff's adjustments to reduce the operating expenses of North Shore and Peoples Gas by $2,000 and $6,000, for lobbying related taxes other than income, respectively, and ~~rate bases of North Shore and Peoples Gas by $6,000 and $14,000, respectively, and~~ operating and maintenance expenses for North Shore and Peoples Gas by $10,000 and $23,000 (gross amounts), respectively, for expenses inherent with lobbying and related activities that were included in the Civic, Political and Related Activities account to be appropriate and uncontested. Thus, these adjustments are approved.

C. Contested Issues

1. Incentive Compensation (Falls in Multiple Categories of O&M)

The Companies' BOE regarding the PO's denial of certain incentive compensation costs principally repeats prior arguments already addressed by Staff and properly rejected by the PO. See NS-PGL BOE, pp. 26-34; Staff IB, pp. 48-66; Staff RB, pp. 11-14. Staff will not burden the Commission or the parties by repeating counter arguments that were previously presented in Staff's briefs. Rather, Staff incorporates those arguments by reference. However, Staff will respond to the Company's new alternative incentive compensation proposal. Staff will also respond to the CUB-City BOE assertion that the Commission has not previously allowed incentive compensation expenses because they *might* benefit ratepayers or the Commission *might* want to see these goals achieved. CUB-City BOE, p. 3.

In their BOE, the Companies for the first time quantify an alternative cost recovery amount for incentive compensation. The Companies' proposal would allow recovery of half of the incentive compensation costs. NS-PGL BOE, p. 33. The Companies present this alternative as if it is in line with AG-CUB witness Mr. Effron's adjustment; however, the Companies' proposal is not related to the AG-CUB proposal. *Id.* The Companies further attempt to justify their alternative proposal by arguing that shareholders should not bear all the costs since the goals benefit both shareholders and ratepayers. *Id.* The Companies' have not demonstrated a reasonable basis to allocate benefits to customers and their alternative proposal is without merit, has no basis in the record or Commission precedent, and must be rejected by the Commission.

The Companies' attempt to justify their proposal by comparing it to the adjustment proposed by AG-CUB lacks merit. First, Mr. Effron never proposed an adjustment which simply split *all* of the Companies' incentive compensation costs in half. Rather his proposal was a disallowance of 50% of the costs paid directly to the employees of the Companies, and 100% of the costs allocated from affiliates. Second, Staff has demonstrated why its adjustment is preferable to that offered by AG-CUB since there is no basis in any Commission order to determine the rate recoverability of incentive compensation based simply on whether or not the costs were incurred as an allocation versus direct cost. Staff IB, p. 66.

Further, in regard to the point that ratepayers also benefit from the goals and should share in the cost, Staff made it clear in its Reply Brief that its position regarding sharing of incentive compensation costs between ratepayers and shareholders is critically conditioned on the utility demonstrating in evidence some reasonable basis to

allocate benefits to ratepayers. Staff RB, p. 14. The Companies provide no basis at all for their 50% proposal, and instead attempt to draw comparisons to other Commission cases wherein a portion of incentive compensation costs were allowed. PGL-NS BOE, pp. 30-33. One such case is *Commonwealth Edison Co. v. Ill. Commerce Comm'n*, ___Ill. App. 3d___, 2009 Ill. App. LEXIS 913 (2d Dist. Sept. 17, 2009) ("*ComEd 2005 Appeal*"), wherein the Commission allowed recovery of half of the incentive compensation costs. The Companies go as far as saying that the PO's reliance of the Court's affirmation of the Commission decision in the *ComEd 2005 Appeal* is unsound. PGL-NS BOE, p. 30. The record is clear, though, that such award of half recovery of incentive compensation costs was not an arbitrary allowance to split the difference between ratepayers and shareholders, as the Companies propose here. Staff RB, pp. 12-13. In fact, the *ComEd 2005 Appeal* makes clear that 100% of incentive compensation costs based upon financial goals shall not be recoverable in rates. *Id.* The PO's reliance on such appeal is timely and sound.

In the CUB-City BOE, CUB-City argues that the PO's conclusion against Staff's incentive compensation adjustment for goals unlikely to be achieved should be reconsidered. The CUB-City BOE asserts that the PO ignores the evidence that demonstrates these goals are unlikely to be achieved and therefore improperly inflates the Companies' revenue requirement. CUB-City BOE, p. 2. CUB-City is correct in asserting that the Commission has not previously allowed incentive compensation expenses because they *might* benefit ratepayers or the Commission *might* want to see these goals achieved. *Id*., p. 3. Staff did not address this issue in its BOE. However to be clear, Staff concurs with the CUB-City exception and still maintains that the Staff

adjustment to disallow incentive compensation related to goals unlikely to be achieved is warranted.

In summary, the record shows that Staff's adjustments for incentive compensation properly apply the standards that the Commission has used repeatedly.

VI. RATE OF RETURN

E. Cost of Common Equity

Throughout this proceeding, the Companies have adopted an unfortunate approach of questioning Staff's integrity with unsupported insinuations and allegations of ethical breaches regarding Staff's estimation of the Companies' costs of common equity.

The Companies presume to ascribe motivations for Staff's decisions, lamenting that Staff is biased against them. For example, the Companies' reference to the "real reason for that conversion" implies that, because of some hidden agenda, Staff presented a false explanation for its current use of a non-constant DCF model." NS-PGL BOE, p. 41. In fact, despite Staff's perfectly valid rationale that a non-constant DCF model was selected due to the clear unsustainability of near-term growth rates (ICC Staff Exhibit 7.0R, pp, 4-5), the Companies state that "the more plausible explanation for Staff's conversion to a non-constant growth form of the DCF model is Staff's realization that a non-constant growth form of the model could generate suppressed equity costs if lower growth rates were assumed in the later stages of the model." NS-PGL BOE, p. 42. The Companies further claim that Staff's analysis is "results-driven" and reflects a "manipulation" of the models. NS-PGL BOE, pp. 42-43. The Companies also falsely insinuate that, based on a bias in its financial risk

adjustment methodology, Staff rarely, if ever, makes upward adjustments to the cost of common equity for financial risk -- which is ironic, since every cost of common equity adjustment the Companies present is an upward adjustment. NS-PGL BOE, p. 45. These are but a small sample of the unfounded accusations the Companies have repeatedly made throughout this proceeding. The clear, but absolutely false, implication of these comments is that Staff's analysis is biased against the Companies.

For the Companies to level such accusations against Staff, and to go so far as to warn the Commission that it "should not countenance such manipulation of the financial models," (NS-PGL BOE, p. 43) would be amusing, if not for the seriousness of the matter, since Staff is the only party in most proceedings, including this one, that has no incentive to bias its cost of common equity results one way or the other. What the Commission should not countenance is the low-road tactics against Staff the Companies have chosen. In fact, arguments like those the Companies present only show their eagerness to deviate from the substance of an issue and the merits of competing arguments, and do nothing to help the Commission decide such issues. It must be made clear that such unacceptable behavior will not be tolerated. If the Commission fails to censure such inappropriate tactics there will be no motivation for parties to refrain from them in the future.

Exception No. 11

The Companies argue that GDP growth does not represent a mathematical cap for a company's sustainable growth, stating that "logic dictates that one component can grow indefinitely at a rate higher than GDP growth if it is offset by lower growth rates of other components." Instead of using GDP growth to estimate long-term growth, the

Companies propose to substitute corporate profit growth, which represents one of the 14 GDP components Mr. Moul identified. NS-PGL BOE, p. 38; NS-PGL Ex. PRM-2.0 Rev., p. 17. However, the Companies' "solution" is nothing more than a red herring, as it merely substitutes one way of breaking down GDP for another. The question of whether or not a single component of GDP can sustain growth greater than that of GDP as a whole remains. Contrary to the Companies' assertion, logic clearly dictates that it cannot. As Mr. McNally explained, to assume otherwise would be to accept that a subset of a group can become larger than the group itself, which is obviously false. Staff IB, p. 101. As the slower growth components become infinitesimally small relative to the higher growth component, their ability to "offset" the higher growth component becomes immaterial and the growth of the higher growth component must approach that of the overall group. Thus, that the higher growth of one component may be offset by lower growth rates of other components only delays the ultimate result.

Even if it were possible for corporate profit to grow faster than the overall GDP, there is no evidence to suggest that investors expect any single component of GDP (of the 14 components Mr. Moul named) to grow to dominate GDP, which would happen if corporate profit could sustain greater growth than that of the GDP, as the Companies suggest. In addition, just as GDP can be broken down into its components, corporate profit, too, can be broken down farther. For example, corporate profit can be broken down by industry. There is no reason to substitute corporate profit for GDP as a proxy for the long-term growth of the Gas Group when one could substitute the forecasted growth for the utility industry specifically, which would clearly be a better proxy. Finally, since earnings growth is the product of the earnings retention rate and return, if

companies pay all of their earnings out as dividends (retention rate = 0%), there would be no sustainable growth regardless of the level of corporate profit. Thus, the level of corporate profit growth obviously cannot be assumed to be a reasonable estimate of earnings growth. ICC Staff Exhibit 21.0, p. 12.

While Staff defers to the Companies as to the summary of their arguments regarding this exception, Staff clearly disagrees with those arguments and recommends the Commission reject them since they are without merit. .

Exception No. 12

The Companies' twelfth exception to the PO relates to the PO's summary of their arguments challenging Staff's estimate of the risk-free rate for the CAPM. NS-PGL BOE, pp. 38-39. The Companies argue against Staff's use of a spot rate and propose the use of Blue Chip forecasted yields instead. NS-PGL Ex. PRM-2.0 Rev., pp. 24-25. The Companies' arguments do not withstand scrutiny. Specifically, Staff's review of a recent Blue Chip forecast found that not only did those projections consistently exceed actual interest rates, but their accuracy diminished as the forecast period lengthened. Moreover, since the current U.S. Treasury yields Staff used to measure the risk-free rate reflect all publicly-available information, any influence the Blue Chip forecasts might have on investor expectations is already reflected in the current U.S. Treasury yields. Thus, the Commission should continue to rely on current, observable market interest rates rather than the projected rates the Companies propose. ICC Staff Exhibit 21.0, pp. 15-16.

Again, while Staff defers to the Companies as to the summary of their arguments regarding this exception, Staff clearly disagrees with those arguments and recommends the Commission reject them since they are without merit.

Exception No. 13

The Companies' thirteenth exception relates to the PO's discussion of the information presented concerning the general conditions of the capital markets as they relate to the Companies' costs of common equity. NS-PGL BOE, pp. 39-41. While Staff does not agree with many of the arguments put forth in the Companies' BOE in defense of this exception, Staff neither supports nor opposes the accompanying proposed language changes.

Exception No. 14

The Companies' fourteenth exception relates to the PO's discussion of the parties' DCF analyses. Specifically, it relates to the PO's inclusion of the results of Staff's non-constant DCF analysis in its determination of the appropriate costs of common equity in this proceeding. NS-PGL BOE, pp. 41-43. Staff disagrees categorically with the Companies' proposed language changes associated with this exception. Staff strongly recommends the Commission adopt the language presented in Staff's BOE. Staff BOE, pp. 37-40. Nevertheless, regardless of the Commission's opinion of Staff's proposed language, it clearly must reject the Companies' proposed language.

The Companies argue that "Staff has failed to explain why its use (and this Commission's acceptance) of the constant growth form of the DCF model was reasonable until 2008, and why it was appropriate then to switch to the non-constant

growth version." NS-PGL BOE, p. 41-42. The Companies' argument is erroneous. There is no legal burden on Staff in this proceeding to justify what was done in 2008; nor is that relevant to this proceeding. However, despite the Companies' clearly fallacious claim to the contrary, Staff did explain why the use of a non-constant DCF is appropriate in this proceeding. ICC Staff Exhibit 7.0, pp. 3-5. Staff could not have been more explicit. Unlike the Companies, the PO properly recognizes that fact.

The Companies also argue that the non-constant DCF is typically reserved for firms with extraordinarily high near-term growth rates that are unlikely to be sustainable in the long run. NS-PGL BOE, p. 42. Staff agrees, inasmuch as atypically high, unsustainable growth is "extraordinary." Such is the case in this proceeding. As Staff explained, Staff's average near-term growth estimate for the companies in the Gas Group is more than 60% greater than that expected for the overall economy, while Mr. Moul's is 40% greater. ICC Staff Exhibit 7.0, p. 5; Staff BOE, p. 35. The sustainability of such above average growth is a mathematical impossibility. Moreover, it is even more implausible that investors expect the companies in the Gas Group to sustain above-average growth given their below-average earnings retention rates and below-average risk and return, both of which are indicators of below-average growth. Thus, it is Mr. Moul's utilization of a constant growth DCF in this proceeding that is inappropriate rather than Staff's use of a non-constant growth DCF.

Finally, in a revealing line of reasoning, the Companies' response to Staff's demonstration that the Companies clearly misrepresented a FERC decision regarding the use of a non-constant DCF is to note that Staff "stops short of claiming that the FERC would apply the non-constant growth form of the DCF model under the

circumstances of these cases." Staff RB, pp. 32-34; NS-PGL BOE, p. 43. That is, in response to being exposed for making inappropriate claims regarding a FERC position, the Companies suggest that Staff's position is somehow weakened by the fact that Staff did not make an inappropriate pronouncement regarding a FERC position about which Staff can only speculate. The reason Staff stopped short of making such a claim is that Staff is unwilling to make definitive declarations regarding what the FERC would do in a hypothetical scenario. Nevertheless, Staff does note that the FERC stated, "we gave four reasons why the long-term growth of the United States economy as a whole is a reasonable proxy for the long-term growth rate of all firms, including regulated firms in the gas business." Staff RB, p. 33. Thus, like the texts Staff cited, the FERC, too, apparently feels that the long-term growth of the overall economy is a reasonable proxy for the long-term growth rate of gas utilities.

Exception No. 15

The Companies' fifteenth exception relates to the PO's acceptance of Staff's financial risk adjustment. NS-PGL BOE, pp. 43-46. The Companies claim to have identified two fatal flaws in Staff's approach. As explained below, the Companies exception is without merit. Like the PO, the Commission's final Order should accept Staff's financial risk adjustment.

For the first "fatal flaw," the Companies suggest that Staff's financial risk adjustment is based on an "apples-to-oranges" comparison of hypothetical credit ratings for the Utilities that assume full recovery of their revenue requirement to the actual credit ratings of the Gas Group. Id., p. 44. The Companies suggest that Staff's approach is biased to produce a lower cost of equity, as it is based on an assumption of full recovery of the Companies' revenue requirements.

The Companies' claim of a bias actually reflects their own bias that causes them to ignore a fundamental aspect of risk, namely, that the Companies' risk of recovery of their revenue requirements is a two-way street, as Mr. Fetter acknowledged. Tr., p. 501. That is, a utility can under-recover, which hurts the utility, or it can over-recover, which hurts its ratepayers. The Companies' argument focuses solely on the potential for under-recovery. In contrast, Staff's assumes neither over- nor under-recovery, avoiding either upward or downward bias. Thus, the Companies' argument against Staff's approach is merely a self-serving attempt to protect themselves against the risk of under-recovery, while ignoring the risk to rate payers of over-recovery. The Commission must balance the interests of both the Companies and their customers and would be remiss if it were to adopt the Companies' disregard for the risk to rate payers.

In continuation of their argument, the Companies state that Staff is "simply wrong" to assert that its risk adjustment methodology is just as likely to produce an upward adjustment as a downward adjustment since the implied rating of the target company will not be systematically higher or lower than those of the sample companies to which it is compared. The Companies argue that Staff's assumption of full recovery of the revenue requirement causes Staff to understate the Companies' financial risk. NS-PGL BOE, p. 44-45. Once again, the Companies ignore the fact that risk is a two-way street. The Companies' argument is premised on the assumption that utilities will under-recover their revenue requirements, rendering the ratings implied by Staff's revenue requirement recommendations overly optimistic. However, the Companies

failed to demonstrate that their earnings could not exceed their cost of capital,[1] and while they may petition for rate increases specifically to address under-recovery, they proposed no mechanism for returning earnings greater than their cost of capital. In fact, the Companies' suggestion that Staff's financial risk adjustment should not be adopted because achieved returns may deviate from the authorized return is contrary to the concept of cost-based rate making. They made a similar argument with regard to their 13th exception, in which they cited Mr. Fetter's testimony that he believes that to provide a cushion in difficult economic times the authorized return on common equity should be set, not at cost, but above the required return. Id., p. 39. Clearly, to overstate the Companies' required rate of return for the possibility that their achieved returns may deviate from the authorized return is not just and reasonable.

The Companies also note that "Staff fails to identify even one instance in which its methodology resulted in an upward adjustment of a utility's ROE." Id., p. 45. While that is true, the Companies did not raise this argument in testimony, affording Staff no opportunity to introduce such evidence into the record. Moreover, Staff could likewise note that the Companies failed to identify even one other instance in which Staff's methodology resulted in a downward adjustment of a utility's ROE. Thus, the Companies have not exposed a pattern of bias, as they imply. Furthermore, Commission Orders generally contain no discussion of Staff's upward risk adjustments, not because they are never made, but because utilities' self interests deter them from contesting them, and the details of uncontested issues are often omitted. Nevertheless,

[1] In fact, the Companies went over 12 years without a rate increase, from November 1995 (Docket No. 95-0031/95-0032 to February 2008 (Docket Nos. 07-0241/07-0242), despite their right to file for a general rate increase. This suggests that the Companies earned their cost of capital or more during an extended period.

Staff does observe that the Orders in Docket Nos. 05-0071 and 03-0398/03-0399/03-0400/03-0401/03-0402 (Consol.) note that Staff made upward adjustments in both of those proceedings to reflect the higher risk of the target utilities relative to the samples from which the cost of common equity was derived. Docket No. 05-0071, November 8. 2005, p. 53; Docket Nos. 03-0398/03-0399/03-0400/03-0401/03-0402 (Consol.), April 7, 2004, p. 15. Moreover, Staff is presenting upward adjustments in the current Ameren and MEC rate cases and is recommending use of the higher risk sample in the current IAWC rate case, based on the same methodology used in this proceeding.

Incredibly, the Companies contest Staff's statement that "Mr. Moul did not use a single measure of financial risk in his sample selection process." NS-PGL BOE, p. 45. That the Companies would deny an indisputable fact, regarding their own testimony no less, severely undermines their credibility. Mr. Moul unambiguously described his sample selection process as follows:

> Q. How did your selection process provide the companies that you included in the Gas Group?
> A. I began with the universe of gas utilities contained in the basic service of Value Line, which consists of twelve companies. Through the application of my screening process, I eliminated three companies. These were NiSource due to its electric and natural gas pipeline/storage operations, Southwest Gas due to its location and UGI Corporation because of its highly diversified businesses. The remaining nine companies are identified on page 2 of Peoples Gas Ex. PRM-1.3. I will refer to these companies as the "Gas Group" throughout my testimony.

North Shore Ex. PRM-1.0 Rev., p. 3; Peoples Gas Ex. PRM-1.0 Rev., p. 3.

Thus, Mr. Moul's sample selection process included three criteria: primary line of business, location, and diversification of operations. Each of those criteria reflects a

company's business risk and, as Staff correctly observed, clearly has nothing to do with financial risk.

For the second "fatal flaw" in Staff's financial risk adjustment, the Companies claim that, since that adjustment "reflects zero risk to the utility's ability to recover its revenue requirement in full," "no other rider could have any further effect on the utility's revenue recovery or financial risk, and any additional adjustment to its authorized return would be duplicative and punitive." Thus, the Companies recommend that the Commission reject either Staff's financial risk adjustment or its rider adjustments. NS-PGL BOE, pp, 45-46. Staff notes that the Companies cite no record evidence in support of its argument. That is because none exists; the Companies conjured this argument from the ether. Since the Commission cannot base its decisions on extra-record testimony, it must disregard this argument entirely. Nonetheless, the Companies' argument is without merit.

The Companies suggest that Staff's risk adjustment removes all risk that a utility will be unable to recover its revenue requirement in full. That is not true. The Companies' argument is based on the false premise that the authorized return should reflect its recent past achieved results, rather than investors' expectations of future risk. However, under cost-based rate making, the authorized return on common equity is set equal to the investor required return,[2] which is revealed through the price investors are willing to pay for that common stock. It cannot be determined by past achieved returns. As noted above, investors' perception of the risk of a utility reflects the possibility of both under-recovery and over-recovery of its revenue requirement. Obviously, a utility's past

[2] As long as that investor required rate of return is lawful; that is, is not excessive due to unreasonable and imprudent management actions or affiliation with non-utility companies.

experience with deviations from its revenue requirement influences its investors' expectations of those risks in the future. However, that influence is already embedded in the utility's stock price. Nevertheless, the Companies suggest the Commission should attempt to interpret investor expectations from a small sample of past deviations from the authorized return rather than rely on objective market data to determine the investor required return. Ironically, this is precisely what the Companies warned the Commission about in their BOE, stating, "if … the Commission ignored general financial market conditions and objective information about what investors expect, and instead established authorized return based on subjective, value-laden judgments about what investors should expect, it would do so at the customers' peril." NS-PGL BOE, p. 40.

In fact, if Staff's risk adjustment removed all risk that a utility will be unable to recover its revenue requirement in full, that would render an investment in a utility's common equity nearly risk-free. However, with the financial risk adjustment (but before rider adjustments), Staff's common equity return recommendations of 9.89% and 9.79% clearly still reflect a significant level of risk compared to the risk-free rate of return of 4.10%. ICC Staff Exhibit 7.0R, pp. 13-15, 21. Since Staff's financial risk adjustment served to produce a cost of equity to reflect the risk embedded in the Companies prior to the consideration of the effects of the riders, adding the riders would further reduce the Companies' risk. That is, the 9.89% and 9.79% costs of equity would be appropriate if all of the Company's proposed riders were rejected. In contrast, to the extent the Commission adopts any of the proposed riders, additional adjustments would be necessary.

Finally, contrary to the Companies' claim, Staff's recommendations are clearly not punitive. In fact, recent trends in utility capital costs and current economic data demonstrate that Staff's cost of common equity proposals are quite consistent with the current economic climate and are, if anything, generous. Therefore, it is not Staff's proposals that are understated, but the Companies' proposal that are excessive. Staff RB, pp. 25, 50-53.

XIII. TRANSPORTATION ISSUES

C. Large Volume Transportation Program

1. Super Pooling on Critical Days

In their respective BOEs, the Companies and CNE-Gas describe an alternative proposal that address the concerns raised by CNE-Gas. NS-PGL BOE, pp. 51-53; CNE-Gas BOE, pp. 3-5. The proposal by the Companies is acceptable to Staff. However, Staff prefers the descriptive language of the compromise methodology offered by the Companies (NS-PGL BOE, p. 244) because it is more thorough than CNY-Gas, but Staff prefers the conclusion offered by CNE-Gas, which appropriately addresses the findings of the PO regarding the validity of CNE's original proposal. CNE BOE, Attachment A, p. 7.

Therefore, consistent with the foregoing, Staff recommends that the PO be modified as follows:

Recommended Language
PO, p. 243

d) Compromise Methodology

In their Brief on Exceptions, the Utilities stated that they discussed super pooling with CNE-Gas and proposed a method under which suppliers would be able to take steps to reduce or avoid penalty charges on Critical

Days. This method differs somewhat from CNE-Gas' proposal, but it accomplishes the same objective. The proposal applies to Critical Days, which means that it applies to Rider SST customers and suppliers serving Rider SST customers under Rider P, as Critical Days have no adverse effect on Rider FST. When the Utilities declare a Critical Day, suppliers would have the opportunity to notify the Utilities, in writing by the first business day of the month following the Critical Day, that they intend to participate in a Critical Day Reallocation. "Reallocation" means that a supplier may, after-the-fact, move gas that it delivered to one or more of its Rider SST pools on a Critical Day to another one or more of its Rider SST pools. For example, assume a supplier has three Rider SST pools and delivered 100 units to each pool on a Critical Supply Shortage Day. One pool incurs unauthorized use charges that delivery of an additional 25 units would have avoided while the other two pools incurred no such charges and, in fact, had sufficient deliveries on that day that each could transfer (reallocate) deliveries to the first pool and still incur no unauthorized use charges. The supplier may make reallocations that, in this example, eliminates the unauthorized use charges for the first pool.

The reallocation will occur after the Utilities reconcile consumption for the month in which a Critical Day(s) occurred. Suppliers would determine what reallocation of deliveries, if any, they will request for a given Critical Day(s). The supplier must submit, in writing, its reallocation. The Utilities would execute the reallocations prior to billing the month in which the Critical Day(s) occurred. This method gives suppliers the tools to avoid Critical Day unauthorized use charges through delivery reallocations that the suppliers choose. As such, it meets the goals of "super pooling."

~~d~~e) Commission Analysis and Conclusion

CNE-Gas proposed that ~~Peoples Gas~~ the Utilities permit Super Pooling on Critical Days, which allows all third party groups, or pools, that are under common management to be balanced in aggregate for the application of Unauthorized Usage Charges. A Critical Day is either a "Supply Surplus Day" or a "Supply Shortage Day." We agree with CNE-Gas that this is a reasonable proposal. A supplier should be able to have its penalties changed when it can show that its other commonly-managed Rider ~~13 Groups'~~ P Pools' Critical Day deliveries would have eliminated the Unauthorized Use condition in whole or in part.

The Commission agrees with CNE-Gas that because the Utilities suffer no harm on critical days when a supplier's usage overall complies with Utilities' rules, then no penalties should be assessed. Accordingly, we find CNE-Gas to have reasonably addressed the concerns raised in the last rate case. No overhaul of the Utilities' billing system should be necessary. We also rely on Staff testimony that the Utilities would not be entangled in the supplier/customer relationship with this new proposal.

> The proposed method allows the utility to work on the billing discrepancy directly with suppliers, who pay the Critical Day penalties, instead of with customers, and therefore would not entangle the Companies in the supplier/customer relationship. The Commission is only requiring a waiver of penalty charges, if after the Critical Day, a supplier is able to show that, in aggregate, its pools have excess deliveries of sufficient quantity to alleviate all, or a portion of, any incremental charges and penalties incurred.
>
> As both CNE-Gas and the Utilities have agreed upon an acceptable methodology for implementing Super Pooling on Critical Days, the Commission has no objections to its use.

D. Small Volume Transportation Program (Choices for You[SM] or "CFY")

1. Allocation of and Access to Company-owned Assets

The ALJs were very clear in the PO that they found change to be needed in the area of the Companies' small volume transportation program and the allocation of and access to Company owned-assets. Accordingly, the ALJs included language in the PO ordering workshops to ensure that reasonable changes are made. PO, p. 256. The Companies agree to the workshops but sidestep the PO's decision by recommending the deletion of statements about the need for workshops. NS-PGL BOE, pp. 53-55; NS-PGL Exceptions, pp. 260-261. Even though this is a formal proceeding, the Companies' track record on CFY is one of non-responsiveness. See PO, p. 256 ("The Utilities chose not to seriously respond to RGS' proposal."). It is Staff's position that a strong mandate in the PO seems appropriate to ensure the Companies' cooperation in an informal process.

RGS states, "if the Commission decides to accept the Proposed Order's establishment of workshops, then the Commission should state that the final CFY rules and procedures should contain the injection and withdrawal rights and targets contained in the Nicor choice program and that the specific rules and procedures implementing

those injection and withdrawal rights and targets can vary from the Nicor Gas program only where good cause can be shown." RGS BOE, p. 11.

The Companies attempt to argue that they can only address the tariffs and not other facets of the administration of the program. Companies BOE, p.54. They claim that they cannot make Nicor Gas discuss its program which RGS uses as a model. However, this claim is unreasonable because Staff cannot think of any reason that Nicor Gas would not discuss other aspects of their programs with the Companies. Nicor Gas is not a competitor here. Additionally, Staff has found Nicor Gas willing to engage in discussions regarding their program. Finally, other intervenors that currently are served by both programs would serve as another source that the Companies could approach. If the desire to learn is there, certainly the means exists.

Finally, on the remaining small volume transportation issues (XIII., D., 2-7) that RGS insists be decided at this time (RGS BOE, pp. 11-16), Staff agrees with the PO's decision to make the workshops comprehensive. PO, p. 256.

Therefore, consistent with the foregoing, Staff proposes that the Commission adopt the following modification of the alternate language that RGS proposed in its BOE. RGS BOE, Proposed Language section, p. 3-4.

Recommended Language
PO, p. 256

Commission Analysis and Conclusion

> RGS provided compelling evidence to show that the CFY program is not functioning as well as it could. This evidence showed CFY participation at only 3%. Staff acknowledges the need and supports changes in the Utilities' CFY program. While it is clear that changes to the CFY program are needed, nothing more of clarity appears on the record. RGS recommends a wholesale adoption of the program recently approved by the Commission for Nicor. Whether this would be appropriate for the

Utilities' choice program is not known because the Utilities chose not to seriously respond to RGS' proposal. Accordingly, we are left with an incomplete record.

Having found that the Utilities should adopt the recommendations of RGS and Staff, the Commission believes that it is necessary for the parties to work together to formulate language that tailors the Nicor choice program provisions for access to and allocation of company assets to the Utilities' operations. ~~The Commission cannot order wholesale changes without a complete discussion of the particulars and an analysis that explains what we are being asked to adopt.~~ Thus, Staff's proposal to hold workshops is the only reasonable option of record to address the CFY program.

The Commission directs the Utilities to come to the workshops prepared to discuss the Nicor program. The Utilities should be prepared to explain which parts are appropriate for their program, which are not, and why they are not. For those parts of the Nicor program that the Utilities believe are not appropriate for their program, they will come prepared to present alternates to address the issues raised by RGS.

The workshops will cover all the small volume transportation program issues. The workshops participants shall be technical and other in-house working personnel from the affected companies and the Commission Staff.

The Commission wishes to make it clear that it has already ruled that the CFY program must include the key aspects of the Nicor program identified by the Commission Staff (Staff Brief at 197):

1. daily injection and withdrawal rights based on the methods provided in RGS Ex. 1.1 – Daily Storage Withdrawal Capacity and Daily Storage Injection Capacity.

2. monthly targets for injections and withdrawals based on the method provided in RGS Ex. 1.1 – Storage Inventory Target Levels.

3. daily delivery targets provided by the Companies based on the best estimate of the customer's daily usage with a daily tolerance of ±10% like RGS Ex. 1.1 – Daily Delivery Range.

Thus, the only Allocation of and Access to Company-owned Assets issues to be discussed at the workshops will be how to implement these changes, and not whether they should be implemented.

XIV. FINDINGS AND ORDERING PARAGRAPHS

Appendix B

The Companies proposed a correction to Appendix B for a "very minor allocation error," which is set forth below. NS-PGL BOE, p. 56. While Staff does not object to the

correction proposed by the Companies, the correction should be made on page 3 of 18 not page 2 of 18. The Companies correction therefore should have been as follows:

> Appendix B on page ~~2~~3, column (l) shows an adjustment of $9,000 for company use gas to Distribution expenses, but it should be split $2,000 to Other Production Expenses and $7,000 to Distribution Expenses. NS-PGL Exs. CMG-3.2N, SM-3.2N. That slight difference is rolled up in the aggregate figures on lines 8 and 9 of page 1 of Appendix B, so the same split should be reflected there as well.

CONCLUSION

Staff respectfully requests that the Illinois Commerce Commission approve Staff's recommendations in this docket.

Respectfully submitted,

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